

# THE EVOLUTION OF PROVINCIAL FINANCE IN BRITISH INDIA

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### A CRITIQUE OF THE CHANGE

It is obvious that good administration depends upon good finance; for finance is " the fuel of the whole administrative machine. " No aspect of the scheme of Reforms therefore demands a closer and more anxious study than the financial arrangements with which the new system of administration starts. The necessity for such an examination is all the greater because this aspect of the Reforms Scheme has received comparatively little intelligent criticism at the hands either of the public or the expert.

The first question to consider is, can the new financial arrangements be said to be *administratively* workable ? To make administrative polities independent by requiring them to finance themselves entirely out of their own respective resources without having to depend upon one another must always be regarded as a very important end to be kept in view in devising a new financial arrangement. It is true that it is not always possible to realise this end, and it may in some cases be actually helpful to their working that the polities should be made mutually dependent; for interdependence, at least in matters of public finance, instead of being an impediment might conceivably furnish a basis for co-operation and strength. None the less independence in finance for each administrative policy is to be sought for wherever possible. There can be no doubt that from this standpoint the system of contributions is better than the system of divided heads. This is not to condemn the system of divided heads. The existence of several concurrent or overlapping tax jurisdictions must always be a source of difficulty whenever an attempt is to be made to distribute the different sources of revenue among the competing tax jurisdictions so as to allow each a sufficiency of funds. The reason is that this distribution of the sources of revenue must not only be governed by considerations of adequacy, but must also be governed by considerations of suitability. " The problem of efficiency of taxation, " as Prof. Seligman observes,

"is naturally of vital importance. No matter how well intentioned a scheme may be, or how completely it may harmonise with the abstract principles of justice, if the tax does not work administratively it is doomed to failure."

Whether among the sources of revenue to be partitioned there are any which are naturally more suitable for utilisation by one tax jurisdiction rather than by another depends upon what is the basis of the tax. If the basis of the tax is narrow then the argument in favour of its utilisation by a narrower tax jurisdiction will be correspondingly stronger. If its basis is wide then the scales would weigh in favour of its utilisation by the broader tax jurisdiction. But as a result of following the dictates of suitability it is not always possible to make a partition such as to give each administrative polity revenues adequate for its purposes. For it may happen that a particular tax is suitable for one jurisdiction while its yield, instead of being necessary for that jurisdiction, may be required for another jurisdiction which is unfit to levy it, or may be partially necessary for both. In such a case, how are the ends of adequacy to be subserved? Two remedies suggest themselves. One is the adoption of the system of divided heads, and the second is to apportion the deficiency among the several component states and require them to make a definite contribution towards meeting it.

The system of divided heads was by no means peculiar to the Indian fiscal system. It has been adopted in some form or other by many other countries. In England, for instance, the inheritance tax is assessed by the Central Government, but a part of the proceeds is allotted to the Local Government. The same is true of some other taxes in England. In Germany, under the Empire, the proceeds of certain indirect taxes were divided between the federal and state governments. In Canada it is well known that a large part of the provincial revenues is derived from proceeds of taxes that are levied by the federal government.

The prejudice in India against the system of divided heads of revenue is particularly regrettable because it is founded on the view that it is opposed to the principle of separation of revenues. People who opposed it said that it involved divided heads of expenditure which fettered the spending powers of the Provinces and enabled the Government of India directly to interfere in their Budget estimates and "to have its finger in every pie" of theirs. The system of divided heads was no doubt characterised by these objectionable features. But division of expenditure is not a necessary accompaniment of division of revenue. Nor is it a necessary incident of it that a polity which shared in the yield of a tax but did not administer it should interfere in calculating the estimates of the yield. Chipped of its evil features, the system of divided heads of revenue is simply another name for what Prof. Seligman calls the system of segregation of source and the division of the yield. The essence of the system consists in the exclusive assessment of a particular source of revenue by one tax jurisdiction, coupled,

however, with an apportionment of a part of the proceeds to another tax jurisdiction. The system of divided heads of revenue does not cease to be a system of separation of sources merely because there is the division of the yield. In such a system of divided heads there is a separation because the assessment of the tax is segregated—which is the essence of separation—exclusively in the hands of one tax jurisdiction, and the division of the yield can be so regulated that it need not be incompatible with real separation.

The system of contributions does what the system of divided heads aims to do. Like the system of divided heads it answers the tests of suitability as well as of adequacy by allowing the tax to be administered by the jurisdiction most competent to do it, and also of adequacy by making the taxing jurisdiction hand over a sum to the non-taxing jurisdiction. Essentially the system of divided heads and the system of contributions are alike. The only difference between the two is that so far as the apportionment of proceeds are concerned the one is an itemised arrangement while the other is a lump-sum arrangement. There is therefore really nothing much to choose between them. But this is not altogether a case of merely giving a different name to a discredited system in the hope that it might smell more sweet. For the system of contributions has one real point of superiority as compared with the system of divided heads. It does not merely permit of separation of assessment, but it also makes for a greater separation than does the system of divided heads. Under the system of divided heads the receiving party has still an anxious concern in the assessment and collection of the tax for any laxity in the administration of a divided head of revenues is bound to affect its interests adversely, and may therefore claim a hand in the administration of the tax. But under the system of contributions there is no room for such a possibility. Its quota being assured it is out of the business of assessing and collecting the tax. There is thus a greater separation under the system of contributions than there can be under the system of divided heads.

When we come to analyse the equity of the new financial arrangements we find that great objections are raised to the system of contributions. But many of these objections are misconceived. It will be recalled that the contributions from the Provinces to the Central Government in India are regulated according to their spending powers. In other words, it is the apportionment by expenditure method of dealing with the deficit. That the method subserves the ends of adequacy is of course obvious. But what does not seem to be so obvious, but which all the same is a great virtue of the system of contributions, is that it promotes economy in the giving as well as in the receiving tax jurisdiction; for extravagance in the contributing tax jurisdiction immediately increases its burden, while extravagance in the receiving tax jurisdiction is directly reflected in enhancing the contributions. None the less, the contributions, it is protested, are iniquitous, for they are held to be based not on population, nor on area, nor on wealth, nor on the capacity of

the Provinces. It is also complained that the system of contributions according to spending powers is unwise, for it tends to check desirable expenditures in the more progressive Provinces. The latter is, of course, a real objection to the apportionment by expenditure method of contributions in its general form. But it may be said, on the other hand, that in the first place if a jurisdiction is willing to undertake the burdens of a larger expenditure for desirable aims, it will scarcely be deterred by the slight additional burden which might result from the increase in the contribution. Secondly, if it were found that the contribution did produce such a result it would be possible to obviate it by adopting the simple expedient of exempting certain kinds of expenditure which might be deemed to be necessary. What these expenditures should be would be a matter of adjustment, which might differ in different provinces. The virtues of the system of apportionment by expenditure method of levying contributions would still be conserved intact, and its automatic features would work equally well if certain expenditures only, instead of all expenditures, were selected as the basis of calculations.

This objection cannot, however, be urged against the Indian system of contributions. In the first place, the contribution is not a varying sum as is the case in the financial systems of other countries. Because the Provinces are made contributory towards the deficit of the Central Government it is to be remembered that they are not liable to the whole of the central deficit whatsoever it may be from year to year. On the other hand, in ordinary years the Provinces are only liable to make contributions towards meeting what is called the Standard Central Deficit of Rs. 9.83 lakhs. That being the case the contributions do not form an element of uncertainty in the Provincial Budgets. Secondly, the contributions are not a permanent feature of the financial arrangements between the Central and Provincial Governments. The levy of the contributions is contemplated to be only transitional, to allow the Government of India to work out its financial salvation, and the Government of India has promised that they will adopt such a policy as to bring about the extinction of the contributions in as short a time as possible. Lastly, the ratio of the contributions to the standard revenues or expenditure of any of the Provinces is not so great as to place a heavy incubus on their financial system, and not being a varying quantity cannot be said to check useful expenditures by Provinces which propose to incur them.

As a matter of fact whatever may be said against the flaws in the apportionment by expenditure method of levying contributions it would be difficult to deny that the system eminently answers the requirements of equity. It certainly brings about a more equitable distribution of the burden than is possible under other systems. For it may fairly be assumed that expenditures very nearly correspond to the actual abilities of the communities concerned more than do population or area. Not only is the principle equitable in itself, but care has been taken to do

equity in its application as between the different Provinces. For we know that the contributions are so regulated as to leave to the Provinces, rich as well as poor, a reserve of spending power in order to enable them to meet such of their pressing needs as may not have been covered by the figure for standard expenditure. The main purpose of rejecting equal in favour of unequal contributions was to see that the burden of the contributions did not prevent any of the Provinces from meeting such extra expenditure as may be absolutely necessary. Indeed, no system of contributions can be said to be calculated to produce greater equity than the Indian system.

So far we have examined whether the new financial arrangement is administratively workable and equitable. What we have now to see is: Has the arrangement proved itself to be financially adequate? It will be recalled that the Financial Relations Committee held that the general resources of the country were abundant, and that it required only a wise plan of distribution in order to leave each Province with a sufficiently large "spending power" or surplus.

(In Thousands of Rupees)

Province		Standard Figures	Revised 1921-2	Budget 1922-3
	Revenue	14,98,02	15,58,59	16,76,50
Madras	{ Expenditure	14,07,20	17,15,93	17,18,55
	{ Surplus and Deficit	90,82	—1,57,34	—42,05
	Revenue	12,09,70	13,67,13	14,93,06
Bombay	{ Expenditure	11,55,03	16,52,80	15,42,17
	Surplus and Deficit	54,67	—2,85,67	—50,11
	Revenue	8,55,28	8,86,53	10,55,86
Bengal	{ Expenditure	8,61,13	11,10,60	10,36,90
	Surplus and Deficit	—5,85	—2,24,07	18,96
	Revenue	12,29,88	13,34,31	13,58,67
United Provinces	{ Expenditure	12,06,56	14,59,87	13,85,65
	L Surplus and Deficit	1,23,32	—1,25,56	—26,98
	{ Revenue	9,73,51	10,73,76	11,38,26
Punjab	{ Expenditure	9,10,69	12,23,24	12,68,44
	{ Surplus and Deficit	62,82	—1,49,48	—1,30,18
	{ Revenue	8,24,28	9,99,33	10,00,57
Burma	{ Expenditure	7,84,78	10,27,51	11,90,70
	{ Surplus and Deficit	39,50	—28,18	—1,90,13
	{ Revenue	4,30,39	4,46,15	4,62,65
Bihar and Orissa	{ Expenditure	4,20,70	4,85,97	5,13,80
	{ Surplus and Deficit	90,69	—39,82	—51,15

	{ Revenue	4,35,37	5,14,80	5,35,23
Central Provinces	{ Expenditure	4,38,80	5,41,76	5,72,17
	{ Surplus and Deficit	—3,43	—26,96	—36,94
	{ Revenue	1,81,46	2,01,12	2,08,06
Assam	{ Expenditure	1,78,25	2,19,45	2,22,58
	{ Surplus and Deficit	3,21	—18,33	—14,52

That the plan recommended by the Committee was calculated to bring about such a result must of course be taken for granted. But when we analyse the Budgets of the different Provinces since the introduction of the Reforms the result appears to be entirely disappointing ( see Table, p. 287).

Thus, taking the estimated revenue and expenditure of the nine Provinces for 1922-3, equilibrium between current revenue and expenditure is only to be found in two of them, Burma and Bengal, and in the latter this result could not have been attained but for the temporary remission of its annual contribution to the Central Government, and a programme of taxation calculated to bring in Rs. 140 lakhs. In the rest of the Provinces the deficits of the year aggregated to the large figure of Rs. 7,74 lakhs. This huge deficit was financed by new taxation to the extent of Rs. 3,52 lakhs, and for the rest by drawing on balances and by raising loans from the public and from the Central Government. But as the Secretary of State in his despatch pointed out, this

" process of financing provincial deficits in part from the accumulated revenue balances of the past will now practically come to an end, as such balances will be generally exhausted by the end of the current financial year..... If the financial stability of the Provinces is not to be undermined, with ultimate jeopardy to the Government of India itself, it is impossible to contemplate the continuance of a series of Provincial deficits financed by borrowing either direct from the public or from the Central Government."

What is to be the remedy ? At the Conference held in Simla in April, 1922, "to consider various matters connected with the financial arrangements between the Central Government and the Provinces, " it was disclosed that the Government of India and the Provinces were divided as to the proper solution for the rehabilitation of Provincial Finance on a stable and secure footing. The Provinces proposed an increase in their resources by revising the financial arrangements made by the Reforms Act. On the other hand, the Secretary of State as a mouthpiece of the Government of India urged that

" Equilibrium can only be achieved by reduction of expenditure and the adoption of measures which will lead to an increase of revenue"

The Provinces were not, however, unanimous in the suggestions they made for the revision of the arrangements effected by the Act. Some like the Government of Bombay suggested a return to the system of " divided heads " while others

were opposed to it. But the majority was for securing relief through the abolition of contributions. This attitude of the Provinces towards the new financial arrangements is on the face of it a very unreasonable attitude. They are opposed both to the system of divided heads and the system of contributions as well. This is to have things both ways, and they could certainly have had it if the existing resources of the country had been properly husbanded. Inadequacy of finance is not always the result of a paucity of revenue resources. National prosperity may be great and growing and the increase of national wealth may be proceeding unchecked. If under such circumstances enough revenue is not obtained the fault does not lie with the social income. Rather it is a fault of the government which must be said to have failed to organise and marshal the national resources for fiscal purposes. The same is to some extent true of the Indian Government.

Surveying the national resources of the country, it becomes evident that there are two sources which the Government has not been able to marshal properly. One is the land revenue. It is notorious that land revenue has been the biggest resource to the Government of India. In the collection of the land revenue every landholder is laid under contribution, but the rate of assessment is not periodically enhanced for every one of them. On the other hand, in Bengal and in other parts of India the rate of assessment is permanently settled. Consequently in such parts of India which by the long period of settled government enjoyed by them, and by the consequent influx of capital, have attained to a greater advance in prosperity than any others, the land revenue yields practically no increase; the land-owners, with enormously increased incomes, contribute nothing to the increase in the financial burdens of the State. Permanent Settlement has ever since the days of Lord Canning been suggested as a panacea for improving the financial condition of the people. After the severe famine of 1860, Lord Canning, then Viceroy and Governor-General of India, recommended the extension of the Permanent Settlement to all parts of India. Sir John (afterwards Lord) Lawrence supported the recommendation, and the two Secretaries of State for India, Sir Charles Wood and Sir Stafford Northcote, approved of the proposal. Fortunately for the country the proposal for making the Permanent Settlement universal was finally rejected in 1883. Some no doubt regarded the decision as unfortunate, and continued the agitation in favour of the permanent Settlement long after. But the real force, if there was any in the agitation, was derived from the motive of putting a limit on the financial resources of an alien and an irresponsible bureaucracy. Those who then agitated in favour of the Permanent Settlement probably did not realise that some day this irresponsible bureaucracy would give place to a responsible government of the people and the Permanent Settlement which it was desired to be instituted as a curb on the unchartered licence of a bureaucracy would result in placing a fetter on the freedom of a popular government to enter upon the path of orderly progress. A bad government may

abuse its financial powers, but a government cannot be a good government if there is a serious limitation on its financial powers. It was therefore a good thing that this evil of a permanent settlement was not allowed to spread to the whole of India. But it would have been better if the new financial arrangements had contrived to replace the permanent settlement system of land revenue by a periodical settlement system. That was one important way of augmenting the general resources of the country and thereby giving adequacy to all the governments concerned. Instead of this the financial arrangements were so conceived as not to

"subject the permanently settled provinces to financial pressure which would have the practical result of forcing them to reconsider the permanent settlement." If this had been done it would have augmented the general resources to the benefit of all. As it was, not only provision was made favouring the retention of the Permanent Settlement, but the Bengal Government, which has the largest number of permanently settled holders of land, was later on exempted from contributing to the Government of India which was compelled to meet its deficit in other ways.

Land Revenue therefore is one source which the Government could have marshalled in the interest of giving adequacy to the new financial arrangements. The other source which the Government refuses to tap is the customs revenue. The kind of fiscal policy that was adopted during the pre-Mutiny days, was, as we know it to be, of a suicidal character. The same is true of the post-Mutiny fiscal policy. From the Mutiny up to the present time, the Government of India has never looked upon the customs revenue as a resource to be used to meet the exigencies of the State, and when it has used it, it is only very reluctantly, and never to the fullest, not to mention the circumstances when it has actually reduced its revenue from this source in spite of the crying needs of the exchequer. While the ostensible reason given in favour of such a fiscal policy is that the customs revenue is wrong in principle, everybody knows that the customs revenue is not raised in India because it is feared that under it Indian industries would be protected against English industries. That the whole policy of India has been dictated by the interests of English manufactures is beyond dispute, and the reason for it is not far to seek. The Secretary of State for India, the supreme executive for India, is directly amenable to the English voters, whose primary concern has been to see that their markets are not closed against them. Whether a protectionist policy is good or bad is another question. For the present it is sufficient to note that the Government of India has been subjected to a pernicious kind of limitation on its fiscal powers which prevents it from using a source of revenue which has everywhere else proved to be most elastic and abundant of financial resources. If these limitations were not there the present financial inadequacy in all probability might not have ensued at all, and there



would have been no necessity either for adopting the system of divided heads or for imposing contributions. As it is, owing to these limitations on the taxable resources of the country, a deficit in the Budget of the Central Government is inevitable. Given this fact, the adoption of some method of meeting that deficit was imperative, and there is no doubt that the system adopted is better than the system it replaced. In the present circumstances of the finances of the Central Government, contributions must be taken as a settled issue. Nor can it be said that the abolition of contributions would restore stability to Provincial Finance. Such no doubt is the prevalent view of the Provincial Governments and also of non-official politicians. The Resolution moved in the Indian Legislative Assembly on the 14th September, 1922, rested on the same view that if the Government of India were only to dispense with the contributions it would immediately restore equilibrium in the financial position of the Provinces. This belief was strengthened by the assumption that the aggregate estimated deficit of all the Provinces disclosed itself to be 352 lakhs of rupees for the financial year 1922-3; and as the total contribution to the Imperial Government by the Provinces aggregated to the sum of 983 lakhs, a remission of this amount would more than wipe off the deficit in the Provincial Budgets. It must, however, be said that the deficit of 352 lakhs of rupees does not disclose the true position of the Provinces as derived from the financial arrangements made by the Act. If we are to deduce the true position of the Provinces as following from the new arrangement we must take note of the new taxation imposed and of the gain to Bengal through the remission of its contribution to the Imperial exchequer. Making adjustments for these, the position of the Provinces as it would have been without contributions may be seen from the following :—

**FINANCIAL POSITION OF THE PROVINCES 1922-23**  
(In thousands of rupees)

Provinces	Revenue	Expenditure	Surplus or Deficit
	Rs.	Rs.	Rs.
Madras	15,99,00	17,18,55	—1,19,55
Bombay	14,32,06	15,42,17	—1,10,11
Bengal	9,15,86	10,99,90	—1,84,04
U.P.	13,58,67	13,85,65	—26,98
Punjab	11,38,26	12,68,44	—1,30,18
Burma	10,00,57	11,90,70	—1,90,13
Bihar and Orissa	4,62,65	5,13,80	—51,15
Central Provinces	5,35,23	5,72,17	—36,94
Assam	2,05,06	2,22,58	—17,52
	Total deficit		—8,66,60

According to this calculation the aggregate deficit of the Provinces would have been about 867 lakhs. But we must make some further adjustments to this account. It has not been possible to deduct from the revenues of the Central Provinces the sum derived from the enhancement of the Excise duty in the Provinces. Secondly, the revenues of the Central Provinces for the year 1922-3 include collections of suspended revenue of previous years. If these adjustments were made the aggregate deficit of the Provinces would give rise to a figure which would be barely covered by the remission of contributions. We must therefore conclude that remission of contributions would have at best been a very inadequate measure for removing the financial stringency of the Provinces, even if the problem of financing the extra deficit caused by such remission in the budget of the Central Government were to be ignored.

But if remission of contributions cannot improve the difficult situation that has arisen with regard to Provincial Finance, we must go to the root of the matter and inquire what are the causes which have brought on that situation. Is it due to the normal expenditure of the Provinces being under-rated ? Or is it due to the normal revenues of the Provinces being over-estimated ? For this purpose we must first ascertain whether the resources allocated to the Provinces were really inadequate to their normal needs. The following table compares the standard receipts and expenditure and shows the margin left between them for covering a probable advance in expenditure.

STANDARD REVENUE AND STANDARD EXPENDITURE

Provinces	Standard Revenue	Standard Expenditure	Excess or Defect of Standard Revenue over Standard Expenditure
	Rs.	Rs.	Rs.
Madras	14,98,02	14,07,20	90,82
Bombay	12,09,70	11,55,03	54,67
Bengal	8,55,28	8,61,13	—5,85
U.P.	12,29,88	11,06,56	1,23,32
Punjab	9,73,51	9,10,69	62,82
Burma	8,24,28	7,84,78	39,50
Bihar and Orissa	4,30,39	4,20,70	9,69
C. P.	4,35,37	4,38,80	—3,43
Assam	1,81,46	1,78,25	3,21

From this it is obvious that except in the case of two Provinces the standard revenue has left a sufficient margin over standard expenditure. Only in Bengal and Central Provinces there was no margin, owing to the fact that the standard

expenditure was slightly in excess of the standard revenue. But this defect was more than remedied in the case of Bengal by the remission of the contributions to the Central Government, and the excess of standard expenditure over standard revenue in the case of Central Provinces was indeed very small. Barring this, in the rest of the Provinces the margin allowed was substantial. Let us now turn to the actual figures and compare them, with the standard figures. First of all, let us take the revenue side of the Provincial Budgets. Has the realised revenue fallen short of the standard revenue ? The following table compares the realised receipts of the Provinces with the standard figure assumed to be the normal in the financial allocation made under the new Act :—

#### PROVINCIAL REVENUES

Provinces	Standard Revenues	Increase over Standard : — Decrease from Standard.	
		For 1921-22	For 1922-23
		Rs.	Rs.
Madras	14,98,02	60,57	40,41
Bombay	12,09,70	1,57,47	2,22,36
Bengal	8,55,28	31,25	60,58
U.P.	12,29,88	1,04,43	1,28,79
Punjab	9,73,51	1,00,15	1,64,75
Burma	8,24,28	1,75,05	1,76,29
Bihar and Orissa	4,30,39	15,76	32,26
C. P.	4,35,37	79,43	99,86
Assam	1,81,46	22,60	23,60

The above table brings out very clearly the fact, not readily admitted, namely that the realised revenue has in no case fallen short of the standard revenue. It may, however, be asked : Has the increase in the realised revenue been equal to the margin allowed under the allocation between the standard revenue and of the Provinces ?

As throwing some light on that aspect of the question the following table is interesting:-

#### EXPANSION OF PROVINCIAL REVENUES

Provinces	Standard Margin	Excess or Defect of Realised Margin over Standard Margin	
		For 1921-22	For 1922-23
		Madras	90,82
Bombay	54,67	1,02,80	1,68,19
Bengal	—5,85	25,40	54,73

U.P.	1,23,32	—18,89	5,47
Punjab ... .. .	62,82	37,33	1,01,93
Burma	39,50	1,35,55	1,36,79
Bihar and Orissa	9,69	6,07	22,57
C. P.	3,43	76,00	96,43
Assam	3,21	19,39	20,39

From these figures it is obvious that except in the case of Madras the realised margin has in no case fallen below the standard margin. The excess of the realised over the standard margin is enormous. It cannot, therefore, be said that the financial deficit in the Provinces is due to provincial revenue having failed to reach the assumed normal. On the other hand, the revenues were more than necessary to cover the normal expenditure of the Provinces. The only conclusion that can fairly be drawn from the facts of the case is that the provincial deficits are due to an extraordinary increase in the expenditure of the Provinces. The following figures furnish enough evidence in support of this view:—

Provinces	Standard Expenditure	+ Increase over Standard : — Decrease from Standard.	
		For 1921-22	For 1922-23
Madras	14,07,20	3,08,73	3,11,35
Bombay	11,55,03	2,97,77	3,87,14
Bengal	8,61,13	2,49,47	1,75,77
U.P.	11,06,56	3,43,31	2,79,09
Punjab	9,10,69	3,12,55	3,57,75
Burma	7,81,78	2,42,73	4,05,92
Bihar and Orissa	4,20,70	65,27	93,10
C. P.	4,38,80	1,02,96	1,23,37
Assam	1,78,25	41,20	44,33

We are, therefore, led to the view held by the Secretary of State that reduction of expenditure and increase of taxation is the only remedy for placing provincial finance on a sound footing.

What chances are there that the Provinces will undertake the reduction of expenditure and increase of taxation so very necessary for their safety ? In this connection it is well to recall the dictum of that great financier, Mr. James Wilson, who once said:

" Finance is not mere arithmetic; finance is a great policy. Without sound finance no sound government is possible: without sound government no sound finance is possible." If there is any truth in this, then whether or not the

Provincial Governments will undertake economy or face increase of taxation depends upon whether or not the system of government established in the Provinces by the Reforms Act is a sound system. Now, what is the nature of the government that is established in the Provinces under the Reforms Act ? In common parlance the system is known as dyarchy. Under it the Executive of the Province, instead of being composed of the Governor in Council as before, is now divided into the Governor in Council and the Governor in Ministry. Under it the subjects marked off as Provincial from the Central are further divided into " Reserved " and " Transferred " subjects. The former are in charge of the Governor in Council, and the latter in that of the Governor in Ministry. Of these parts of the Provincial Executive the Council in charge of the "reserved" subjects still remains as before irresponsible to the Provincial Legislature, is unremovable by it, and in that sense is a non-parliamentary executive. The other part of the Provincial Executive, namely the Ministry in charge of the "transferred" subjects, is recruited from the elected members of the Provincial Legislature, which is made responsible to the Provincial Legislature which is based on a more or less popular franchise, and is removable by it, and in that sense is a Parliamentary Executive.

The Provincial Legislature is supreme with regard to both the parts of the Provincial Executive. It has not only full powers of legislation, but has also full and unfettered powers of interpellation. Its powers of sanctioning and voting upon the Provincial Budget are complete, although provision is made in the Reforms Act, which allows that

" the Local Government shall have power in relation to any such demand (for a money grant) to act as if it had been assented to, notwithstanding the withholding of such assent or the reduction of the amount therein referred to (by the Provincial Legislature), if the demand relates to a reserved subject (which is assigned to the charge of the Governor in Council) and the Governor certified that the Expenditure provided for by the demand is essential to the discharge of his responsibility for the subject."

Can such a government tackle the problems of sound finance? It is obvious that of the two parts of this dyarchical Executive, one, i.e. the Governor in Council, need have very little anxiety for reduction of expenditure or for the increase of taxation. It derives its mandate from Parliament, and as such is free to adopt any policy—backed up as it is by the certification power of the Governor without any regard for the best interests of the taxpayer. The authors of the Joint Report had seen that this certifying power to override the wishes of the Legislature might lead to irresponsible extravagance on the part of the Governor in Council, and had proposed to endow the Governor in Ministry with a countervailing power which was to act as a curb on the former. That power was to have consisted in the Proviso which laid down that no taxation even in the interests of the

"reserved" subjects should be imposed in any Province without the consent of the ministry. The Extremists—a class of politicians in India who were bent upon minimising the reforms as being inadequate—disliked the proviso as calculated to make scapegoats of ministers and to bring them into discredit with the people. But their rivals, the "Moderates," now calling themselves "Liberals"—one does not know why—saw clearly what the proviso meant. If this had materialised, there can be no doubt that the ministry would not have been a mere outsider tendering advice to the Council which might be accepted or rejected, but would have obtained a powerful voice in the settlement of the budget.

Having regard to the fact that no minister unless he was in a position to justify the budget proposals, including even those which pertained to the reserved subjects, would have hoped to persuade the Legislature to agree to a proposal of new taxation, the influence of the ministry on the "reserved" subjects, i.e. on the Council, would have inevitably been in the direction of thrift and retrenchment. The moderates were entirely right in their interpretation of the proviso and also in their insistence upon acquiring power, even at the cost of burdening the country with new taxation. But in the heat of the controversy and their desire to convince the public of the substantiality of the Reforms, they drew some very amusing pictures of how the ministers working under the aegis of the proviso would be able to hold the Council at bay. This alarmed the bureaucracy, which raised the cry that it was dangerous to leave the provision for the "reserved" subjects to the tender mercy of ministers who bore no responsibility for the consequences of refusing adequate Budget provision for those subjects. The authors of the Joint Report had realised the force of this argument, and had confessed that the success of the arrangements depended upon their being worked by reasonable men who would conduct themselves in a reasonable manner. They were probably right in refusing to assume that the ministers would not co-operate, either by reducing their own claims or by imposing taxation, in order to meet expenditure which the Council considered essential for the proper administration of the "reserved" subjects. But the bureaucracy, which had been frightened by the tactless jubulations of the Moderates, insisted that even reasonable men would at times, in all good faith, differ vitally from other reasonable men when it was a question of providing supply for work which one party was responsible for safeguarding and developing, while the other was only concerned in getting a share of the money. In its opinion circumstances could well be imagined in which reasonableness might not prevail. Let us suppose, it was argued, that the Governor in Council finds new and heavy expenditure imperative on some reserved subject, but that he cannot induce ministers to consent to accept less for their subjects or impose taxation for it. The Governor then, under his exceptional powers, insists on the expenditure being provided for in the next budget, and the result is to leave ministers with inadequate funds for their

transferred subjects. What is to happen ? Are ministers to be compelled to raise a tax which is apparently for their own need, but a need which has been created against their will by the Council refusing to curtail their demands ? Such a procedure, it was pointed out, would be tortuous, provocative, and indefensible. Again, let us suppose that ministers consented to raise the necessary money, but the legislature refused to pass their revenue measures. Are the ministers to resign as having lost its confidence? The bureaucracy placed another dilemma before the authors of the Joint Report. Ministers have raised a new tax for some purpose of their own. In the next budget the Governor finds himself compelled to add substantially to the reserved provision for some new necessity, and thus to curtail the provision for "transferred" subjects. Ministers virtually see their new taxation receipts going to finance some development for which they are not responsible, and of which indeed they may disapprove. What are they to do? To avoid these difficulties the proviso was dropped and in its place the following changes were made in the Devolution Rules:—

#### TAXATION AND BORROWING

30. All proposals for raising taxation or for the borrowing of money on the revenues of a Province shall in the case of a Governor's Province be considered by the Governor with his Executive Council and ministers sitting together, but the decision shall thereafter be arrived at by the Governor in Council, or by the Governor and Minister or Ministers, according as the proposal originates with the Governor in Council or the Governor and Ministers.

#### ALLOCATION OF REVENUES FOR THE ADMINISTRATION OF TRANSFERRED SUBJECTS

31. Expenditure for the purpose of the administration of both reserved and transferred subjects shall, in the first instance, be a charge on the general revenues and balances of each Province, and the framing of proposals for expenditure in regard to transferred and reserved subjects will be a matter for agreement between that part of the government which is responsible for the administration of transferred subjects and that part of the government which is responsible for the administration of reserved subjects.

#### PROCEDURE IN EVENT OF FAILURE TO AGREE

32. (1) If at the time of the preparation of the budget the Governor is satisfied that there is no hope of agreement within a reasonable time between the members of his Executive Council on the one hand and Ministers on the other as to the apportionment of funds between reserved and transferred departments respectively, he may, by order in writing, allocate the revenue and balances of the Province between reserved and transferred subjects, by specifying the

fractional proportions of the revenues and balances which shall be assigned to each class of subjects.

(2) An order of allocation under this rule may be made by the Governor either in accordance with his own discretion or in accordance with the report of an authority to be appointed by the Governor-General in this behalf on the application of the Governor.

#### PERIOD OF ORDER OF ALLOCATION

33. Every such order shall (unless it is sooner revoked) remain in force for a period to be specified in the order, which shall be not less than the duration of the then existing Legislative Council, and shall not exceed by more than one year the duration thereof : Provided that the Governor may at any time, if his Executive Council and Ministers so desire, revoke an order of allocation or make such other allocation as has been agreed upon by them : Provided, further, that if the order which it is proposed to revoke was passed in accordance with the report of an authority appointed by the Governor-General, the Governor shall obtain the consent of the Governor-General before revoking the same.

#### CONDITION OF ORDER OF ALLOCATION

34. Every order of allocation made under these rules shall provide that, if any increase of revenue accrues during the period of the order on account of the imposition of fresh taxation that increase, unless the legislature otherwise directs, shall be allocated in aid of that part of the Government by which the taxation is initiated.

#### PREPARATION OF BUDGET IN DEFAULT OF AGREEMENT OF ORDER OF ALLOCATION

35. If at the time of the preparation of any budget no agreement or allocation such as is contemplated by these rules has been arrived at, the budget shall be prepared on the basis of the aggregate grants respectively provided for the reserved and transferred subjects in the budget of the year about to expire.

Thus rather than depend too implicitly on reasonableness when circumstances must often be provocative effective precaution is taken by these rules against the ministry disapproving the allocation of funds to the " reserved " subjects by allowing the Governor to make such an allocation which is to be binding on both parts of the executive and also by arming him with the power of veto over the Provincial Legislature by allowing the Governor, should he deem it necessary, to restore a Budget grant on a reserved subject if it were refused or reduced by the Provincial Legislature which has the right to determine the Provincial Budget, and thirdly by allowing the Governor in Council equally with the Governor in Ministry to raise new taxation or new loans for the development of the subjects in its own charge. The result is that one part of this dyarchical Executive, namely the



Governor in Council, can have little reason to be interested in economy or be over-weighed by considerations of taxation. Its supply being assured its concern in the stability of provincial finance must be deemed to be somewhat remote. The whole burden of meeting the problem of restoring sound finance, therefore, falls upon the Governor in Ministry in charge of the " transferred " subjects. For, under the distribution and certification powers it is the " transferred " subjects which must go without the funds they need, and it is those in charge of them, namely the Ministers, who must bear the brunt of economy or resort to new taxation to bring about an equilibrium in the finances of the Provinces. For it is doubtful that the Governor in Council will choose the onerous task of raising new taxes or practise economy when there are open to them other ways of amply providing themselves for the subjects they have under their control. Will the other half of the Government, namely the Governor in Ministry, consent to practise economy, or if need be undertake the burden of new taxation ? That obviously depends upon the temper of the Legislature.

At the outset it is to be noted that the Legislature will not readily favour projects of increased taxation. It is true, as Burke remarks, that

" To tell the people that they are relieved by the dilapidation of their public estate, is a cruel and insolent imposition. Statesmen, before they valued themselves on the relief given to the people by the destruction of their revenue, ought first to have carefully attended to the solution of the problem: Whether it be more advantageous to the people to pay considerably, and to gain in proportion; or to gain little or nothing, and to be disburthened of all contribution?"

Whatever may be the philosophers' answer to this question, there can be no doubt that in a poor country like India with a very low capacity for bearing the burden of taxation, it is always very unpleasant, if not cruel, to propose an augmentation of that burden. Besides, any proposals for extra taxation would be shunned as likely to prejudice the chances of the legislators at the polls. So long as nomination was the general mode of obtaining a seat in the Legislature it was unnecessary to mind the prejudices of the electors. But when a seat is in the gift of the elector a candidate to the Legislature who proposes to touch his pocket has a small chance of success, even though the new taxes are to result in more than proportionate benefit. Besides, a political party which has won power from a bureaucracy by accusing it of heavy taxation cannot easily consent to disgrace itself by continuing the same policy. This innate aversion to taxation on the part of the Legislature is strengthened by the peculiar attitude of the Legislature towards the " reserved " and " transferred " subjects. The reserved subjects are those which mostly pertain to peace and order, while the transferred subjects are those which largely pertain to progress. But as has already been pointed out, the policy of the bureaucracy before the Reforms was calculated to sacrifice

progress to order. It is therefore obvious that under the revised constitution the popular Legislatures should aim at turning the scales in favour of subjects tending towards progress. Their aversion to increase of taxation and their partiality for the transferred subjects will favour them to welcome proposals on the part of ministers making drastic reduction in the funds allotted to the reserved subjects. Their attitude towards the ministers will be largely governed by the amount of economy they will be able to effect in the reserved subjects for the benefit of the transferred subjects. Thus in the absence of any very large chances of increase of revenue the two halves of the Executive, the Governor in Council backed by the distribution and certification power and the Governor in Ministry backed by the general Budget powers of, a popular Legislature, will compete in the matter of developing their subjects by forcing economy on each other. The Legislature being unwilling to tax, the Governor in Council being in a position to resist retrenchment and the Governor in Ministry anxious to expand, the chances of an early equilibrium in Provincial finance are very small.

It is, therefore, evident that if there is no sound finance in the Provinces it is because dyarchy is not a good form of government. Now, why is dyarchy not a good form of government ? The answer to this question is very simple. Dyarchy is a bad form of government because it is opposed to the principle of collective responsibility. An administrative machine must work smoothly and harmoniously. But in order that it may do so it must recognise the principle of impartibility of governmental work and a collective responsibility of the administrators in the execution thereof. That the work of government is by its nature impartible may not seem to accord with facts : for, in practice the functions of government can be and commonly are partitioned, as they are between local bodies and between departments. Nevertheless it is true that a common thread runs through them all : that no function of government acts *in vacuo* ; that each reacts on some other function, and that the various functions cannot act at all to produce orderly progress unless there is some force to harmonise them. Otherwise a policy enunciated in one department may fail to fructify for want of helpful action on behalf of other departments. That harmonising force can only be found in the principle of collective responsibility. This is so because under it, as Hearn points out

" Each minister acts in his own department as the recognised agent of his colleagues in that particular department, subject, however, to inquiry and control by the whole body. But in all cases on which any difficulty is likely to arise each minister, from motives not merely of prudence but of honour, takes the opinion of the Cabinet. When the precaution is taken the measure becomes the common act of the Ministry."

Right or wrong there is a common co-ordinated policy which guides a unified government based on collective responsibility. But having made a partition of

governmental work, dyarchy must be said to have introduced an element of divided responsibility in the Executive. It is true that the partition is not horizontal but vertical. It is also true that in setting the two parts to work it has not been provided that there should be two separate Legislatures for two separate executives ; or that each should make its own laws, control its own finance, frame its own budget, impose its own taxation, and raise its own loans ; or that each should have its separate staff for the administration of subjects allotted to it and have its own methods of recruitment, pay and pension for its services ; so that the two authorities might in fact have clearly defined spheres of their own exclusively within them. The Government of India had indeed suggested that some, if not all, of these concomitants of a typically dual executive should also be made a part of the dyarchical system adopted to carry on the government of the Provinces. Fortunately for the country the framers of the new constitution held

"that wisdom lies not in equipping each of the different elements with a complete paraphernalia of its own, and trusting to their orbits lying sufficiently apart for collision to be avoided; but in taking every opportunity of bringing the two elements into contact so as to induce the habits of joint action." " It is our intention," wrote the authors of the Joint Report; " that the Government thus composed and with this distinction of functions shall discharge them as one Government," and that " the Provincial budget should be framed by the Executive Government as a whole."

It was no doubt well to have modified the working of dyarchy by subjecting it to the interplay of two principles, one of division in order to give as clear a definition as possible of the several responsibilities of the two parts of the government and of union, in order to get association in aims and policy between those parts. For to have equipped each part of the Executive with a separate paraphernalia would have been nothing short of a calamity. But because there is an understanding that when ministers will act in matters of transferred subjects the councillors will advise them, and that when councillors will act in matters of reserved subjects the ministers will advise them, it does not alter the fact that dyarchy is a system of divided responsibility. It is not a system which ensures the work of government being conducted in harmony and in accordance with a common policy. On the other hand, it is a system fraught with organised quarrel. The dividing line between dyarchy and anarchy is very narrow. If such a system is not rent in practice it is because of two transient circumstances. One such circumstance consists in the Provincial Legislature being a weakling sapped of its vitality by political dissensions. The other consists in the tenure of the Ministers not being at the will of the Legislature, but for the duration of the Legislature's existence, and are to hold office during the pleasure of the governor. To allow a governor to choose ministers from among the elected members of the Legislature instead of requiring him to accept ministers who are elected by the Legislature is a grave

derogation from the principle of responsible government which was avowedly the object of the Reforms Act. A minister who has the confidence of the governor, and a minister who has the confidence of the Legislature, are two entirely different things. How great is the difference between the two in so far as good government is concerned is writ large in the pages of English political history of the eighteenth and the nineteenth centuries. That such a system should have been adopted against which the whole English constitutional history is a grand protest cannot of course be without some reason. The ostensible reason advanced is that the Legislature

" had had no experience of the power of dismissing Ministers, or the results attending the exercise of such power. Nobody in India is yet familiar with the obligations imposed by tenure of office at the will of a representative assembly. It is only by actual experience that these lessons can be learned..... By the device of appointing the ministers from the elected members of the (Legislature) and making their tenure of office conditional on the retention of their seats (there is) established at once some measure of responsibility, in the form of responsibility to their constituents and thus (is) put an end to the condition of affairs in which those entrusted with the administration are wholly irresponsible to the constituents who elect the (Legislature)."

It is difficult to believe in the cogency of this piece of reasoning. To argue that nothing can be learned without experience is simply absurd. What is necessary for a proper conduct on the part of an individual or a group is to understand the meanings and values of things. For that it is unnecessary to undergo actual trial. A Legislature composed of responsible persons may be trusted to know the consequences of dismissing a Minister at the start without having to wait to learn it by experience. Again, to argue that the system is not the less responsible because ministers are responsible to their constituents is a shallow piece of pedantry. It was no doubt argued by Austin in connection with the English Constitution, that the House of Commons was " merely trustee for the body by which they are elected and appointed." It is true that in a political sense the electors are the most important part of, we may even say, are actually, the Sovereign power, since their will is under every representative system of government sure to obtain ultimate obedience. But as Prof. Dicey points out,

"any expressions which attribute to Parliamentary electors a legal part in the process of law-making are quite inconsistent with the view taken by the law of the position of an elector. The sole legal right of electors under the English constitution (and the same is true under the Indian constitution) is to elect members of Parliament. Electors have no legal means of initiating, of sanctioning, or of repealing the legislation of parliament. No court will consider for a moment the argument that a law is invalid as being opposed to the opinion of the electorate " :

and this exactly defines the status of the Indian electors. To make the minister responsible to such a nonentity is to make him virtually irresponsible. That the framers of the constitution were not alive to these considerations in suggesting this particular mode of appointing Ministers it is hard to believe. What is more probable is that this particular mode of appointing ministers was adopted because it permitted to select a man who was more likely to co-operate with those in charge of the reserved subjects and who being irremovable by the Legislature would be less swayed by its wishes. But the Ministers cannot remain altogether immune from the axe of the Legislature. The dangers of the position of a minister who has cultivated friendship with the councillor and has failed to ingratiate himself into the favour of the Legislature, cannot fail to come home to him on budget occasions. The proposals of the minister as embodied in the budget will be liable to be reversed by a vote of the majority of the Legislature, but neither he himself nor the governor will be able to intervene. The minister's only remedy will be to resign.

Anyhow these circumstances which have, so to say, saved dyarchy from failure are only transitory. The political dissensions may be no more than a passing phase, and the ministers from the second term of the reformed Legislature will become amenable to it : so that before long the forces may be organised better than they are, when dyarchy is sure to fail.

Hybrid executives, divided responsibility, division of functions, reservation of powers, can not make for a good system of government, and where there is no good system of government there can be little hope for a sound system of finance. The primary solution is that there should be an undivided government with a collective responsibility. That, however, can be achieved only when the whole of government derives its mandate from a common source. That such a consummation should take place as early as possible is devoutly to be wished. In that behalf it is encouraging to know that dyarchy is but a transitional system. The only question is how long and protracted will the period of transition be. The justification for introducing a dyarchical form of government rests on the supposition that India is at present ill-prepared to sustain a system of responsible government in anything like completeness, for owing to the lack of education and political experience, the Indian electorate will for some time be unable either to formulate their requirements intelligently or effectively impose a mandate upon their representatives, and that owing to the inveterate social prejudices of the educated classes there is a great danger of their abusing the political power to exploit the masses. This cardinal fact, it was held, must differentiate the degree and the kind of responsibility which can be introduced at the outset from that which will be the eventual resultant of the new system, and must impose the obligation of ensuring that the forces which now hold the people together are not completely withdrawn before satisfactory substitutes are ready to take their

place. On the other hand, it has been urged that there is no necessity to wait till the cardinal fact disappears ; for

"in all countries responsibility in the beginning has been entrusted to a very small section of the people, and government has been in the hands of a small educated minority, who have naturally cared for the interests of the uneducated masses pending the spread of education and the consequent extension of the franchise." This is of course a familiar line of argument which is usually put forth in India by the political radicals and social Tories. If we put aside the painful story of the harsh, cruel and inhuman treatment which the masses in India have accorded to the masses, truth is on their side, for in every country there have been downtrodden communities suffering from social oppression and social injustice, and yet no country has had to be without political power on that account. But those who use this argument forget that if other countries like America with her Negroes and Japan with her Hitas are in possession of political power without having first destroyed social inequality, it is due to the fact of their having been in possession of military power. Military force and moral force are the two chief means to political freedom, and a country which cannot generate the former must cultivate the latter. Thus in India the political problem is entirely a social problem, and a postponement of its solution virtually postpones the day when India can have a free government subject to the mandate of none but her own people.

**THE ECONOMIC JOURNAL**  
**THE JOURNAL OF THE ROYAL**  
**ECONOMIC SOCIETY**

Edited By : J. M. KEYNES AND D. H. MACGREGOR  
London, MACMILLAN AND CO., Limited,  
New York, The macmillan Company, 1926

Of this group only two pretend to add anything new to our knowledge of India, the rest are rather text-books for Indian students. Mr. Ambedkar has the facility of making forbidding subjects attractive and has produced a very readable book. Provincial finance in India has so far been almost entirely neglected by writers on finance and little or nothing has been published apart from Government Blue Books and memoranda. The Evolution of Provincial Finance in British India is a useful introduction written rather from the historical point of view. It does not pretend to be exhaustive and is essentially a piece of pioneer work. There are four parts. Part I traces the history from 1833 up to 1873, when a new regime was begun. Centralisation having proved a failure, the opponents of the system wished " to make the Local Governments partners in the great joint stock of Indian Finances..... instead of keeping them on the footing of agents and

servants, " thus anticipating the present reforms. Opposition, however, was too strong, and as usual the solution was a compromise, details of which are given in Part II. Various methods are described, such as " Budget by Assignments ", " Budget by Assigned Revenues, " and " Budget by Shared Revenue." None succeeded in giving the desired results. Part III is analytical, and is an attempt to that, whatever the financial relationship between the Provincial and Central Governments, the former were never in law or fact independent but were closely regulated. It is an interesting piece of work, but does not appear to be so fundamentally important as the author seems to think. Part IV is devoted to finance since the introduction of the new reforms. The treatment here is not so good, probably because the space allotted to it is too small and the subject very complex. The conclusion drawn is that good finance cannot be expected under the present dyarchical system of government. Certainly it will be difficult.

The author is to be congratulated upon the impartial way in which he has discussed an eminently controversial subject.

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